The nondiscriminatory provisions adopted by the committee are both more specific and more liberal but carefully limited to prevent real discrimination. The committee provisions provide six examples of nondiscriminatory categories of employees which an employer may use for setting up a pension plan, such as employees paid on an hourly basis, employees on a salary basis, or employees employed for a minimum length of time (but not more than 5 years). However, nondiscriminatory plans are not limited to the six listed categories. Moreover, in no case may the plan be discriminatory in favor of employees who are stockholders or key employees.

A plan is considered to discriminate in favor of stockholders if more than 30 percent of the funds are used for stockholder benefits. For this purpose an employee is considered to be a stockholder if he owns 10 percent or more of the company's stock (including stock held by close relatives).

A plan is considered to discriminate in favor of key employees if more than 10 percent of the participants of the plan are in this category. Key employees are the 10 percent in the highest pay brackets (but not more than the 100 highest paid).

In no case, however, is a plan to be considered discriminatory if it covers 25 percent or more of all employees (50 percent if there are less than 20 employees).

Certain requirements must also be met as to nondiscriminatory conditions within the covered group.

For pension or annuity plans the ratio of contributions and benefits to wages or salaries must not be higher for a high-paid employee than a low-paid employee, except that the first $4,000 of wages paid (approximating social-security coverage) can be ignored in establishing the benefits.

For profit sharing or stock bonus plans the same tests apply with respect to 75 percent of the employer's contributions. However, the contributions made on behalf of a high-paid employee cannot be more than twice as high a portion of wages as contributions for a low-paid employee.

A pension trust will be considered as qualified if it already has qualified under existing law.

Certain restrictions presently imposed by regulations are also removed. To qualify a plan need not use a definite, predetermined formula; benefits for beneficiaries may be restricted to the employee's close relatives; and in the case of a profit-sharing plan amounts contributed by the employer may be in excess of current earnings if accumulated earnings are sufficient to cover the contributions.

2. Tax Treatment of an Employee's Exempt Trust

The income of qualified trusts under present law is completely free of tax. Under the committee-adopted provisions qualified pension trusts are treated in the same manner as tax-exempt educational foundations under present law. As a result the income of these trusts generally will be exempt from tax on their earnings. However, they will be taxed on their "unrelated business income" derived from the active conduct of a business or rental income from lease arrangements. Also their exempt status may be removed if they engage in any of the "prohibited transactions," such as making loans to the employer creating the trust without adequate security and a reasonable rate of interest.

In addition, certain restrictions are placed on the investments of the trusts. Their investments in securities of any one company may not exceed 5 percent of the value of the assets of the trust or more than 10 percent of the voting power of the stock of the company. The first of these restrictions also applies to parcels of real estate. These investment restrictions do not apply to existing investments, to investments in the employer corporation (or its parent or subsidiaries), to annuity or retirement income contracts, to Government securities, to cash items, or to investments in regulated investment companies. The income of a trust not qualified or not meeting the investment restrictions is fully subject to tax.

3. Tax Treatment of Employees Receiving Benefits

(*a*) *From qualified trusts.*—The committee provision continues the treatment provided by present law for amounts paid by qualified trusts: the former employee is taxed on the benefits at the time he receives them. As under present law, however, to the extent the benefits represent his own contributions the employee is not taxed. The annuity rule is used to determine the taxable and nontaxable portions of the benefit in these cases.

(*b*) *From nonqualified trusts.*—The committee provision provides the same general tax treatment as far as the benefits paid to employees are concerned in the case of nonqualified trusts as in the case of qualified trusts (however, see below for difference in deduction treatment provided employers). The employee includes the benefits in his income (to the extent not representing his contributions) only when he receives them. Under present law the employee is taxed at the time the employer makes a contribution to a nonqualified trust if he has a nonforfeitable right. If he does not have this right, however, he is not taxed until he receives the benefit, as under the committee provision.

(*c*) *Employee annuities not under trusts.*—The committee adopted a provision which alines the tax treatment of annuities contracts purchased by employers for employees to bring their tax treatment into conformity with that provided for trust pension plans. The changes are as follows—(1) Premiums paid by employers for annuity contracts are not to be taxed currently to the employee, but when payments are received by the employee he is to be taxed at that time on the employer's contribution and also the earnings on the contract. (The new annuity rule is to be used for this purpose.) This treatment is to apply whether or not the contracts come under qualified plans. (2) Under present law only contracts coming under qualified plans receive this treatment. In other cases the employee is taxed at the time the employer makes the premium payments if he has a nonforfeitable right under the contract. (3) The treatment described above for annuity contracts is also to be accorded deferred compensation (but the employer will not be able to take a deduction for this deferred compensation until the employee includes the amount in his income).

4. Tax Treatment of Payments by an Employer

(*a*) *To qualified trusts or plans.*—Subject to limitations, employers under present law may take deductions for payments to a qualified stock bonus, pension, or profit-sharing trust or plan at the time the contributions are made. The committee provisions retain this treatment for payments to qualified trusts or plans although some changes are made in the limitations on these deductions. The more important of these are summarized as follows—(1) At present, employer deductions to qualified pension plans are generally limited to 5 percent of the wages and salaries of covered employees, although greater deductions may be taken if substantiated by the actuarial cost of the plan. The bill would raise the allowable deduction to 10 percent of the wages and salaries of the covered employees, with greater deductions allowable if they can be substantiated on the grounds of actuarial cost. (2) In the case of profit-sharing plans under present law it is possible to obtain a deduction for the purchase of retirement annuities only if purchased through a trust. The committee provision permits deductions for these amounts even though not purchased through a trust, if purchased under a qualified plan. (3) The committee provisions also permit affiliated corporations to act as a unit in making deductible contributions under profit-sharing plans. Present law forbids deductions for contributions with respect to employees of any company in the group which has lost money (and has no accumulated earnings). The committee provision would permit deductions for contributions for these employees if the group as a whole has income (or accumulated earnings).

(*b*) *To nonqualified trusts or plans.*—Under the committee's provisions an employer is allowed a deduction for contributions to a nonqualified trust or plan only when the funds are paid or made available to the employee. The employer cannot take a deduction at the time of making the contribution to the trust unless the benefits are immediately paid to the employee. Under present law the employer can take an immediate deduction at the time he makes a contribution if the employee then has a nonforfeitable right to the benefit but the employer can never take a deduction if the employee's rights are forfeitable at the time a contribution is made to a trust.

EMPLOYEE STOCK OPTIONS

The basic treatment provided for employee stock options as originally provided in the Revenue Act of 1950 and as modified in the Revenue Act of 1951 is retained in the committee provisions unchanged.

As under present law no tax is due at the time of the exercise of a "restricted stock option" or at the time the option is granted. The principal qualification of a restricted stock option is that the option price must be 85 percent or more of the value of the stock at the time the option is granted. If the option price is 95 percent of the value of the stock and the stock held for 2 years (the stock for at least 6 months) the entire difference between the option price and the price for which the stock is sold is taxed as a long-term capital gain at the time of the sale of the stock. If the option price is between 85 and 95 percent of the value of the stock at the time the option was granted the difference between the option price and the value of the stock at the time the option was granted or the value of the stock at the time of its sale by the employee, whichever is lower, is treated as ordinary income. However, this is not taxed to the employee until he sells the stock. The changes are summarized as follows—

(*a*) At present some employees are given an option to buy stock at say 85 percent of the price of the stock at the time the option is exercised. It is impossible to tell in such cases whether the price to be paid under the option is within 85 percent of the value of the stock at the time the option was issued unless the nature of the stock is the same at the time the option was issued and at the time it was exercised. Since these "variable" options appear to fall within the intent of the restricted stock option provision, the committee provided that these options will qualify as restricted stock options if their option price is within 85 percent of the value of the option at the time the option was granted and the other qualifications of restricted stock options are met.

(*b*) At present an option cannot qualify as a restricted stock option if the employee owns more than 10 percent of the company's stock. Under the committee provision this test is to be inapplicable where the option price is 110 percent or more of the value of the stock at the time the option was granted and the option is exercisable for a period of not more than 5 years. Where the option price is above the value of the stock and exercisable only for a short time it is clear that no significant compensation was intended and as a result they must have been issued for other business purposes.

(*c*) The committee adopted a provision providing that the estate or beneficiary of a deceased employee can exercise a stock option and the option will still qualify for restricted stock option treatment. The 2-year and 6-month holding periods, however, are not to apply in these cases. The omission of this provision from present law can represent a real hardship for a deceased employee's family.

(*d*) Under the committee-adopted provision options granted in the future cannot be exercisable over a period of more than 10 years. This eliminates cases where options are granted covering such a long period of time that the employee is almost certain to benefit even though there is no action on his part to increase the success of the employer corporation.

(*e*) Other more technical changes made by the committee include: A provision providing that the transfer of stock purchased with an option to a joint tenancy is not to be considered to be the disposition of the stock (the terminations of the tenancy will, however, if the employee does not get the stock back); a provision providing that if an option otherwise qualifying as a restricted stock option is not held for 2 years (or the stock not held for 6 months) the employee is to include the gains in his income in the year he disposes of the stock (instead of in the year the stock was purchased as at present); a provision indicating that "modification, extension, or renewal" of an option is to include only changes benefiting the employee; and a provision providing that capital changes of the employer corporation are not to affect the rights of employees holding options for stock in their employer corporations.

Committee recessed until tomorrow.

Joint Committee Meetings

AEC PROGRAM

Joint Committee on Atomic Energy: Subcommittee on Research and Development met in executive session with Dr. John C. Bugher, Director, Division of Biology and Medicine of the AEC. Dr. Bugher discussed with the committee reasons for the biology and medicine program, its principal objectives, and facilities and personnel used to accomplish these objectives.

Subcommittee will meet again tomorrow, also in executive session, to consider the AEC 5-year reactor program.

PRESIDENT'S ECONOMIC REPORT

Joint Committee on the Economic Report: Committee continued its hearings on the President's economic report, with testimony on this report as it affects their departments, from Secretary of Agriculture Benson and Foreign Operations Administration Director Stassen. Committee meets again tomorrow.

LEGISLATIVE RETIREMENT

Conferees on S. 2175, retirement of employees in the legislative branch, met in executive session to resolve the differences between the Senate- and House-passed versions of the bill, but did not reach final agreement.

GENERAL TAX REVISION

Committee on Ways and Means: Announced that the following substantive changes were agreed to in the revenue revision bill of 1954:

Tax-Exempt Organizations

The committee made practically no changes in the tax treatment of "tax exempt" organizations, the organizations presently described in section 101 of the code. The one change made in this area relates to a minor change in the unrelated business income tax to which educational, charitable, and certain of the other organizations are subject. Under this tax these organizations presently are subject to tax on their rental income derived from leases of more than 5 years to the extent of indebtedness outstanding which was incurred to acquire or construct the leased property.

It has been called to the attention of the committee that certain organizations have been avoiding this tax by continuous renewals of leases of less than 5 years. To close this loophole the committee adopted a provision which subjects rental income to the unrelated business income tax (beginning in the sixth year) where the lease is for 5 years or less if the same business tenant occupies the property for more than 5 years. However, as in the case of leases for more than 5 years, the tax would apply only to the extent outstanding borrowed funds were used to acquire or construct the leased property.

Tax Treatment of Pensions

The committee adopted a series of provisions revising and rearranging the provisions relating to the tax treatment of pensions. These provisions relate to the deductibility of contributions made by the employer, the tax treatment of the trust (if any is used) which holds the funds prior to their payment to employees, and the tax treatment of the pensions to the employee. These provisions provide that contributions made by employers are deductible at the time made if the plan is a qualified plan, the earnings of the trust are exempt (if it is qualified and does not have unrelated business income), and the employee is taxable on the benefits when he receives them.

1. Qualifications of an Employee's Exempt Pension, Stock Bonus, or Profit Sharing Trust

As under existing law, a trust to qualify must be part of a plan to distribute to employees and their beneficiaries the capital and income of the fund, and capital or income must be available only for the benefit of employees or their beneficiaries.

Under both present law and the provisions adopted by the committee a qualifying plan must also be nondiscriminatory. Under present law a plan, in general, is nondiscriminatory if it benefits 70 percent or more of the employees (or 80 percent of those eligible if 70 percent or more are eligible) or if the Commissioner determines that it does not discriminate in favor of shareholders, officers, supervisory personnel, or highly paid employees.

Lake Michigan by diverting water from Lake Michigan

into the Illinois Waterway.

A separate vote was requested on an amendment offered by Mr. Ford of Michigan designed to prevent any additional diversion of water from the lake until a survey of lake levels had been completed by the Army Corps of Engineers and submitted to Congress, which resulted in the rejection of the amendment by 177 yeas to 202 nays. Rejected two other amendments, while in the Committee of the Whole, designed to limit the water diversion to its present rate; and making diversion dependent on condition of the Illinois River to be determined by the Secretary of the Army.

Adopted an amendment extending the time to January 31, 1957, for completion of a study of the effect on the Illinois Waterway of the increased diversion by the Secretary of the Army. **Pages 1289–1300**

Program for Monday: Adjourned at 4:36 p. m. until Monday, February 8, at 12 o'clock noon.

Committee Meetings

COMMISSIONED OFFICERS

Committee on Armed Services: Maj. Gen. Morris J. Lee, Deputy Chief of Staff for Personnel (Air Force), accompanied by other Defense Department representatives, testified for the second day on H. R. 7103, to establish limitations on the number of officers who may serve in the commissioned grades of the armed services. Committee recessed on the bill to February 16.

ASPHALT VS. CONCRETE

Committee on Armed Services: The Subcommittee on Defense continued hearings in connection with its study of the relative merits of using asphalt for airstrip paving compared to using concrete. Officials of the Department of Defense testifying today were Capt. Martin W. Kehart, Assistant Chief for Operations, Bureau of Yards and Docks (Navy); John M. Ferry, Special Assistant to the Secretary of the Air Force for Construction; Maj. Gen. Roger M. Ramey, Director of Operations (Air Force); Maj. Gen. Lee Washbourne, Director of Installations (Air Force); and L. B. McCloud, Civilian Chief (Construction, Air Force). Hearings will be continued tomorrow.